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TAGS: ETRD ECIN ELTN ETTC PREL CH LA BM VM TH
SUBJECT: GMS: SOUTHEAST ASIA'S BACKDOORS TO TRADE WITH CHINA

REF: A. CHENGDU 69 (YUNNAN'S ROCKY ROADS)
¶B. CHIANG MAI 57 (POOR INFRASTRUCTURE, BORDER INEFFICIENCIES)
¶C. VIENTIANE 88 (FLAGSHIP ROAD DETERIORATES)

CHIANG MAI 00000067 001.2 OF 004

CLASSIFIED BY: Kevin Rosier, Economic Officer, Consulate General, Chiang Mai.
REASON: 1.4 (b), (d)
¶1. (U) This is the third in a series of cables from Consulate General Chiang Mai and Embassy Vientiane on the Greater Mekong Subregion (GMS). These cables have been coordinated with Consulate General Chengdu.

Summary and Comment

¶2. (C) Summary: Unofficial customs fees, poor adherence to rules of origin, and general lawlessness along the Mekong River between Laos and Burma are key characteristics of a porous border area that facilitates informal - and possibly illegal - trade among China and its southern neighbors. For traders seeking to move cargo from one destination to another within the Greater Mekong Subregion (GMS), these features of GMS trade can be either beneficial or harmful to member economies. The history of Chinese apple exports to Thailand and the more recent example of Thai rubber exports to China's Yunnan province demonstrate how the ease of manipulating trade rules in the GMS can affect the flow of trade. Comparing the costs of shipping goods along the Mekong River versus the GMS' R3A and R3B highways versus by sea suggests further that the lawlessness of the upper Mekong region distorts trade flows such that goods are not always shipped in the most efficient ways.

¶3. (C) Comment: The distortions caused by unlawful trade fees and legal shortcomings are an issue of regional concern that should be resolved multilaterally in the GMS framework or bilaterally among its members. As each GMS economy benefits from informal trade in the upper Mekong region, it is unlikely that any one country will take the initiative to address these issues. Of concern globally, however, is whether the informality of trade within the GMS (in particular within the Golden Triangle), combined with falling transportation costs, will encourage the expansion not only of unofficial trade, but also of illegal trade, including of narcotics, sanctioned goods, and humans. End Summary and Comment.

The Myth of ASEAN-China Free Trade

¶4. (C) As China and ASEAN lower tariff barriers under the framework of the ASEAN-China Free Trade Agreement (FTA), local "customs fees" in southern China's Yunnan province and the Wa-controlled part of Burma suggest that, in the GMS, regional trade is not so free. Lao customs officials told Econ staff from ConGen Chiang Mai and Embassy Vientiane that the Chinese are not granting free access to all of the goods agreed upon in the ASEAN-China FTA. According to the Director of Lao Customs in Luang Namtha province, Lao exports (especially agricultural goods) that should enter China duty-free face tariffs that are apparently being imposed at the Yunnan provincial level. (Note: Ref A describes further Yunnan's protectionism.) Lao customs officials said that exporters will try to negotiate with Chinese customs officials on these local duties, but they usually end up paying because the desire to sell to the large, nearby Chinese market outweighs the injustice of the Yunnan tax. The Luang Namtha Customs Director said, "Frankly, it is not easy to work with the Chinese because they do not respect the ASEAN-China FTA. They are not as trustworthy as Thailand or Vietnam." Northern Thai exporters have complained previously to ConGen Chiang Mai Econ staff that they also face unexpected duties (referred to as local value-added taxes) when their exports enter China via Yunnan province.

¶5. (C) GMS experts also explain that unofficial fees imposed in the Wa-controlled area of Burma, where the R3B highway runs from the Thai to the Chinese border, severely limit trade volumes on that route. According to an Asian Development Bank (ADB) study,

the costs of shipping cargo from Bangkok to Kunming along the R3B through Burma in 2006 was $460 per ton, $68 more per ton than along the R3A through Laos, despite the latter route being about 25 miles longer. The report also stated that "the route via Myanmar has the highest perception of uncertainty from a user perspective." The port manager in Chiang Saen (a Thai Mekong River port city) said that although the R3A through Laos (ref B) is a potential competitor to the Mekong River trade route in the North-South economic corridor, he is not concerned about the R3B through Burma because the various bribes and illicit fees that are imposed along the road by ethnic minority groups in Burma make this route too expensive and unpredictable for traders.

A Backdoor to Trade: How About Dem Apples?

¶6. (C) While unofficial fees at the China border and within Burma create barriers to trade in the GMS, the relative lawlessness of the Golden Triangle area, particularly along the Mekong River between Burma and Laos, allows for flexibility in trade flows of certain goods through the North-South economic corridor versus alternative routes. One example is Chinese apple and pear exports to Thailand. Until 2006, Thailand levied a 14% import tariff on these products from China. However, traders avoided this tariff by shipping the fruit mainly through Chiang Saen (instead of by sea directly to Bangkok), thereby

exploiting the weak legal environment of the Mekong region route. When a bilateral agreement eliminated the tariff, the flow of Chinese apples and pears to Thailand began to shift from the Mekong route to the more efficient sea route. The following paragraph details this case.

¶7. (C) Chinese apples have historically been one of Thailand's top imports from China through northern ports, especially through the Chiang Saen Mekong River port. From 2003-2005, apples and pears were the top imports through Chiang Saen. The peak value of Chinese apple and pear imports through Chiang Saen was $16.9 million in 2004. In 2006, after the Thai-China Early Harvest Agreement (a bilateral precursor to the ASEAN-China FTA) brought agricultural tariffs between China and Thailand to zero, apple and pear imports through northern Thai ports fell almost 40%. Since 2006, apple and pear imports fell another 50% down to a value of only $3.4 million in 2008. Economists at the Bank of Thailand's Northern Regional Office argue that the implementation of the Early Harvest Agreement with China explains the dramatic fall in apple and pear imports via northern Thailand. Because Chinese apples and pears are grown in Shaanxi, Shandong, and Hebei provinces, shipping the fruits by truck through southern China, then by boat along the Mekong, and finally by truck again from Chiang Saen to the Bangkok market is surely an inefficient trade route in comparison to the sea route directly from eastern China to Bangkok. According to the Bank's economists, Chinese traders exploited the weak legal environment of the Mekong region to export apples and pears from China to Thailand by avoiding payment of the pre-agreement tariff rate of 14%. It is unclear how Chinese traders used the Mekong River to avoid tariffs on apples and pears - possibilities include disguising the goods as Burmese or Lao in origin or paying bribes to customs officials - but the Early Harvest Agreement implementation marks a clear shift in traders' preferences to use the sea route versus the Mekong River. This is supported by data from a 2008 report by the USDA office at Embassy Bangkok which shows that the drop in quantity of apple and pear imports via Chiang Saen from 2006 to 2007 (16,750 tons) is roughly equal to the increase in quantity imported via Bangkok and Chonburi sea ports in the same year (18,600 tons). (Note: In northern Thailand, the value of actual imports exceeds customs' reported value of imports reflecting the fact that many goods are smuggled. End note.)

¶8. (C) A similar trend occurred with dried longan exports from Thailand to China. While it seemed logical that longan, a common agricultural product grown in the north of Thailand, would be exported to China via northern ports due to proximity, these exports have also fallen in value since 2006 by about 85%. While this could be explained by a drop in demand within China, it seems unlikely given the parallel trends of apple and pear imports and dried longan exports over the same period of time.

A Backdoor to Trade: Rubber Exports to China

¶9. (C) While the Early Harvest Agreement appears to have shifted the trade of these agricultural goods to a more efficient trade route that bypasses the Mekong route, another product - Thai rubber - appears to be benefiting from the "wild west" environment of the upper Mekong. Although some small scale rubber production has begun in northeastern Thailand, the vast majority of Thailand's rubber production is concentrated in the

southern provinces. It is not surprising, therefore, that the newly appointed director of the Bank of Thailand's Northern Regional Office recently told Econoff that she was shocked to see that the top Thai export to China via northern ports is rubber, supposing that most rubber would be exported via Bangkok's ports.

¶10. (C) Thai rubber exports shipped via Chiang Saen port rose more than tenfold over a two-year period, from $5.7 million in 2003 to $65.7 million in 2005. Some experts explain this trend as due to growing Yunnanese demand for rubber. (Note: Expansion of Chinese investment in rubber plantations in Laos and Burma is also evidence of this. End note.) However, that argument must also assume that Yunnanese demand has leveled out since 2005, as rubber export values via northern Thailand have remained roughly the same since.

¶11. (C) An alternative explanation is that trade policies may be affecting rubber trade flows in the same way they did the apple-pear trade. In 2003, the same year when Thai rubber exports through northern ports began to rise, China announced that it would eliminate tariff barriers for rubber products imported from Laos and Burma as part of an overall crop substitution policy to encourage growing rubber instead of opium in these neighboring countries. One rubber company in northeast Thailand admitted that its Chinese customers ship their purchased rubber via northern Thailand and Laos to benefit from the policy, implying that within Laos and/or Burma, origin rules are being manipulated.

¶12. (C) ConGen Chengdu's collected data from the Foreign Trade Division (FTD) of Yunnan's Department of Commerce also suggest rubber traders may be dodging tariff fees by disguising Thai rubber as Lao or Burmese. According to the FTD, although the main exporters of rubber to China overall are Thailand, Indonesia, Malaysia, and Vietnam, recently Vietnam and Burma have become the top exporters to Yunnan province, with Burma accounting for 30% of the total imported rubber in Yunnan province. The remaining rubber imports in Yunnan come from "Laos and other neighboring countries," according to the FTD. With Laos and Burma still at the early stages of developing a rubber production industry, it is highly suspect that these countries have beaten out Thailand in Yunnan's top three sources of rubber.

And the winner is...China

¶13. (C) The highly unofficial nature of trade in the upper Mekong region suggests that China (or Yunnan province specifically) is the winner while its southern neighbors are on the losing side of regional trade. One Chinese "winner" is the Yunnan government (or at least its customs officials), which solicits revenue through provincial level fees that contradict the ASEAN-China FTA. Yunnanese farmers also gain from this provincial protectionism, with customs officials helping to keep out agricultural imports (mostly from Laos) that would compete with Yunnan-produced goods. In the case of rubber, Thai rubber producers arguably gain by having access to more of the Yunnan

market through traders' distortions about where the rubber originated. However, in the long run, once Laos and Burma

become larger producers of rubber for export to China, which will enter duty-free by law, Thai rubber makers may be on the losing end. And certainly Thai, Lao, and Burmese agriculturalists lose from Yunnanese agricultural protectionism.

Time versus Cost

¶14. (U) A lingering question about international trade in the GMS is - as trade flows move to their most efficient routes in the long term - whether the ADB-financed R3A and R3B highways will be competitive vis-`-vis the Mekong River and sea-borne trade. According to an ADB logistics study that estimates GMS shipping costs in 2015, the cost per ton of shipping goods from Bangkok to Kunming via the truck-and-river route (by truck to Chiang Saen then by boat along the Mekong to Jinghong, Yunnan and again by truck to Kunming) will be about half the cost per ton of shipping via the truck-only route from Bangkok to Kunming on the R3A or R3B. Specifically, shipment of goods from Bangkok to Kunming on the Mekong River route is expected to cost $107 per ton in 2015 (currently, the cost is about $270 per ton). Conversely, trucking goods between Bangkok and Kunming is expected to cost $210 per ton on the R3A through Laos and $269 per ton on the R3B through Burma. Cost-wise, even after implementation of a GMS Cross-Border Trade Agreement (CBTA) that will reduce land-based transportation costs, the Mekong River route will remain competitive because of the overall lower cost per unit of transportation by water versus by land.

¶15. (U) On the other hand, the Mekong River route is notably less competitive compared to the highways in terms of transit time. In the same ADB study cited above, shipment of goods from Bangkok to Kunming using the Mekong River is expected to take 70 hours, more than double the 30 hours expected for the R3A and R3B highways. Additionally, the seasonal limits to Mekong River navigation (it can only be used in the May through October rainy season) are a challenge to its competitiveness as a trade route.

¶16. (U) Logistics experts expect that the Mekong River route will remain competitive for the trade of goods that can be ordered earlier in advance and are non-perishable. One example is garments from China. Alternatively, the R3A through Laos (and the R3B through Burma, if it ever becomes a viable option politically) will be the preferred route for trade in goods that are needed on a more timely basis, such as perishable goods, especially ones that are shipped from other Southeast Asian nations for export to China or from China for re-export to elsewhere in Southeast Asia.

¶17. (C) Additionally, the examples of Chinese apple and pear imports and Thai rubber exports highlight the Mekong River's competitive advantage as an informal trade route, especially in comparison to the inexpensive but slower sea route from coastal China to Bangkok. For apple producers in northern China, the sea route from eastern China to Bangkok's ports proved the more efficient route only after concerns about circumventing import duties dissolved (see para 7). In the case of Thai rubber exports, the Mekong remains the more attractive trade route as traders seek to avoid the 20% tariff imposed by China.
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